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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 581

ROYAL INDEMNITY COMPANY, A CORPORATION,
Petitioner,

vs.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Royal Indemnity Company, a corporation, prays that a writ of certiorari issue to review the judgment of the United State Court of Claims entered in this case.

Opinion Below

The special findings of fact and opinion of the Court of Claims (R. 8-32) are reported at 92 F. Supp. 1003.

Jurisdiction

The judgment of the Court of Claims was entered on October 2, 1950 (R. 32). A motion for new trial, timely made, was denied December 5, 1950 (R. 33). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1255 (1).

Questions Presented

A wholly-owned subsidiary filed its separate income and profits tax return for the calendar year 1918, indicating that it owed taxes in the amount of $129,364.93. Thereafter the Commissioner of Internal Revenue determined that said subsidiary was required to file a consolidated return with its parent corporation. The consolidated return was filed. The Commissioner then determined that, by reason of an agreement between the corporations, the entire consolidated tax liability should be assessed against the parent. The parent appealed from this determination and the Board of Tax Appeals upheld the Commissioner, the subsidiary not being a party to the appeal. The Sixth Circuit Court of Appeals affirmed, and this Court denied certiorari. The Government then collected from the *subsidiary's* surety the unpaid balance of the $129,364.93 tax indicated by the subsidiary's original separate return.

The questions are:

(1) Did the Court of Claims err in holding that the said subsidiary (or petitioner surety company, as its subrogee) is bound by the judgment in the earlier case to which it was not a party, and that it therefore is not entitled to a hearing on the question whether taxes paid under the separate return were erroneously collected?

(2) If the subsidiary is bound by the judgment in the earlier case to which it was not a party, did the Court of Claims err in its holding that said judgment established the taxability of the subsidiary?

(3) Did the Court of Claims err in holding that a 1919 waiver of the statute of limitations on collection of the tax was effective in perpetuity, or at least until 1936 when the United States brought suit to collect the tax?

(4) Did the Court of Claims err in holding that the

United States could legally collect a tax from the subsidiary, based on a separate assessment, after successfully establishing that a consolidated assessment was required, and after obtaining judgment against the parent for the entire consolidated tax?

(5) Did the Court of Claims err in holding that the rights of petitioner, as surety on the subsidiary's bond, can be no greater than those of the subsidiary?

(6) Did the Court of Claims err in failing to credit the subsidiary for the $30,000.00 which it contributed toward payment of the parent's tax liability?

Statutes Involved

Revenue Act of 1918, Sec. 240 (40 Stat. 1057, 1081):

> "(a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner, with the approval of the Secretary, make a consolidated return of net income and invested capital * * *, and the taxes thereunder shall be computed and determined upon the basis of such return:
>
> * * * * * * *
>
> "In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each.
>
> "(b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated
>
> "(1) if one corporation owns directly or controls * * * substantially all the stock of the other or others, * * *."

Revenue Act of 1918, Sec. 250 (40 Stat. 1057, 1083):

"(d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. * * *"

Revenue Act of 1924, Sec. 277 (43 Stat. 253, 299):

"(a) Except as provided in section 278 and in subdivision (b) of section 274 and in subdivision (b) of section 279—

* * * * * * *

"(2) The amount of income, excess-profits, and war-profits taxes imposed by * * * the Revenue Act of 1918, and by any such Act as amended, shall be assessed within five years after the return was filed, and no proceeding in court for the collection of such taxes shall be begun after the expiration of such period."

Statement

During the calendar year 1918, Louisville Woolen Mills, a corporation (hereinafter called "Louisville"), was a wholly-owned subsidiary of American Textile Woolen Company (hereinafter called "American"). American had other subsidiaries but their existence is immaterial to the present issues. (R. 9).

Under Section 240(a) of the Revenue Act of 1918, *supra*, American and its subsidiaries, including Louisville, were required to file a consolidated income and profits tax return. However, perhaps in ignorance of this statutory provision—which was enacted in the spring of 1919, only a few days before the due date of the 1918 return—Louisville on

March 15, 1919, filed a separate return for itself alone. (R. 10, 11, 29.)

This return indicated a tax liability of $129,364.93, which Louisville elected to pay in quarterly installments as permitted by law. It paid the first three installments, totaling $97,023.69. On December 20, 1919, Louisville filed a claim for abatement of the fourth installment of $32,341.24, on grounds not here material. In connection with the abatement claim, Louisville gave the Collector its bond, with Royal Indemnity Company (petitioner herein) as surety. This bond guaranteed the collectibility of said $32,341.24, or so much thereof as the Commissioner of Internal Revenue should "find from his rulings to be due," with interest. (R. 10-11.)

On October 26, 1920, the Commissioner advised American that a consolidated return for 1918 should have been filed. This decision was and is accepted by the parties as correct, and is not now in issue. Accordingly, on February 12, 1921, American filed a consolidated return for itself and its subsidiaries, indicating a total tax liability of $351,034.14. Various proceedings were had, and on May 21, 1924, the Commissioner mailed to American an audit letter proposing a consolidated tax of $483,217.93. An administrative appeal resulted in the lowering of this figure to $429,539.94. On October 7, 1925, the Commissioner mailed to the "American Textile Woolen Company and Subsidiaries, Sweetwater, Tennessee" a so-called 60-day letter proposing assessment of a consolidated tax in that amount. (R. 11-17.)

As found by the Court of Claims (R. 17):

> "15. On December 5, 1925, American filed an appeal with the Board of Tax Appeals from the deficiency asserted by the Commissioner in his letter of October 7, 1925. Later, by order of January 14, 1926, on motion of American and with the consent of the Commissioner, the four subsidiaries were brought in as parties to the

> appeal by amendment. Later, and prior to the hearing on appeal, by agreement of American and the Commissioner and with the concurrence of the Board, the subsidiaries were eliminated by appropriate order upon the ground that the deficiency letter of October 7, 1925, was not a statutory notice to the said subsidiaries of the respondent's determination of a deficiency against them."

The only question at issue before the Board of Tax Appeals was whether American and its subsidiaries had made an agreement among themselves for assessment of the entire consolidated tax against American. The Commissioner contended that such an agreement existed and that, as provided by Section 240(a), the entire tax had to be assessed against American. The Commissioner prevailed, the Board holding on June 12, 1931, that the entire consolidated tax was assessable against American. 23 B.T.A. 670. The Sixth Circuit Court of Appeals affirmed, 68 F. (2d) 820 (1934) and this Court denied certiorari, 293 U. S. 558 (1934). (R. 18-22.)

In spite of the said decision that American was liable for the entire consolidated tax, the Commissioner took the position that Louisville was also liable for the tax of $129,364.93, which was indicated by its separate 1918 return. On August 23, 1932, he rejected Louisville's pending claim for abatement of the last quarterly installment of this tax, and thereafter he made demand on Louisville and its surety for the unpaid quarterly installment of $32,341.24, with interest. (R. 23-24.)

Louisville was by then insolvent, and petitioner, as its surety, undertook to defend the claim. Petitioner refused to pay, on the ground that the B.T.A. decision holding American liable for the *entire* consolidated tax had the effect of exonerating Louisville from *any* liability therefor. On August 12, 1936, the United States sued petitioner as

surety on the bond, in the United States District Court. (R. 24.)

Petitioner sought to set up the defense that Louisville was not liable for the tax. The court refused to entertain this defense, and rendered judgment against petitioner for $32,341.24 plus interest. The Sixth Circuit Court of Appeals affirmed, *Royal Indemnity Co.* v. *United States*, 120 F. (2d) 136 (1941), saying (at p. 138):

> "The liability for the tax as tax may have been terminated, though this we do not decide, or, as in United States v. John Barth Co., 279 U. S. 370, 49 S. Ct. 366, 367, 73 L.Ed. 743, collection may become impossible because of the running of time, but this has no bearing upon the obligation of the surety upon the bond."

The court held that, the bond having been given to guarantee the *collectibility* of the tax, and being conditioned only on the Commissioner's determination that a tax was due—not on a *correct* determination—the surety was obligated to pay. This Court denied certiorari, 315 U.S. 797 (1942). Petitioner then satisfied the judgment in full by payment of $93,545.80 to the United States. (R. 24.)

On May 15, 1943, petitioner as subrogee of Louisville's rights filed a timely claim for refund of said $93,545.80, with interest. After rejection of the claim, this action was timely brought in the Court of Claims to recover the refund. The Court of Claims entered judgment for the defendant. (R. 24, 32.)

Reasons for Granting the Writ

1. The decision below is not only wrong, but departs so far from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. (See Rule 38(5)(b).)

Incredible as it seems, the Court of Claims has ruled that

it is possible for the United States to collect (and keep) a tax without granting the taxpayer a hearing on its legality, even though the taxpayer has neither waived his rights nor slept on them. That is the shocking and extraordinary result which will ensue unless this Court takes jurisdiction and reverses the judgment below.

Louisville had a meritorious defense to the Government's claim for 1918 taxes, namely, that the entire consolidated tax had been assumed by American. The Government itself, in resisting American's appeal, had successfully contended for this position before the Board of Tax Appeals. The B.T.A. decision was appealed to the highest court possible, and cannot be questioned by the Government since it was a party to that case.

Louisville endeavored to join in that earlier case in order to obtain there a hearing on its tax liability. Louisville was dismissed out of the case, however, because the Government had failed to give it the statutory notice which was a jurisdictional prerequisite to review by the B.T.A.

Louisville (*i.e.*, petitioner as its surety) then resisted collection in the District Court. Again no hearing could be had on the merits of the tax liability, because the Government was entitled to collect without regard to the correctness of the assessment, leaving the taxpayer to test out the merits in a refund suit. The District Court so held, and its decision was appealed to the highest court possible.

Petitioner then paid the tax and brought this suit for refund. For a third time, it has now been ruled that no hearing can be had on the merits of the tax. The court below recognized that the merits were not foreclosed by the decision in the suit on the bond. It held, however, that the decision in the B.T.A. proceeding—to which Louisville was not a party—had rejected Louisville's claim on the merits.

The circle is now complete. Louisville could not contest

the tax before the B.T.A. because the Government had made it impossible for Louisville to become a party. Louisville could not contest the tax before the District Court because the merits were not open in a suit on a collection bond. And Louisville cannot contest the tax in this case, so the Court of Claims has held, because the B.T.A. decision "cannot be questioned here."

The opinion below does not explain how Louisville can be bound by a decision in a case to which it was not a party. Perhaps it was thought that Louisville was bound because American, its parent corporation, was a party. But it is well settled that the distinct corporate personality of affiliated corporations will be respected unless the device of separate incorporation has been used to defeat the ends of justice. *Page* v. *Haverty,* 129 F. (2d) 512 (C.C.A. 5th 1942). *Signal Oil & Gas Co.* v. *United States,* 125 F. (2d) 476 (C.C.A. 9th 1942). And no hint of fraud, or even of sharp practice, appears in the record. Indeed, the action of the B.T.A., in dismissing Louisville's appeal while simultaneously deciding American's, was utterly meaningless except on the assumption that for the purpose of determining 1918 tax liability the two corporations are to be regarded as separate persons.

By dismissing Louisville's appeal, the B.T.A. said as plainly as it could that its decision was *not* intended to foreclose Louisville's rights. This ruling cannot reasonably be ignored as an empty technicality. For, although Louisville was a wholly-owned subsidiary of American, petitioner was *Louisville's* surety only—not American's. After the dismissal of Louisville's appeal, petitioner therefore had no standing to assist in the further proceedings. Indeed, as the Court of Claims found (Finding 29, R. 23), petitioner did not even learn of the B.T.A. decision until after it had been appealed to the Circuit Court of Appeals.

The Court of Claims has, however, ignored Louisville's absence from the B.T.A. case. In so doing, it has denied a hearing on the merits of Louisville's tax liability. Deprivation of property without a hearing is such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

2. The decision below conflicts with the decision of the Sixth Circuit Court of Appeals in *American Textile Woolen Co.* v. *Commissioner*, 68 F. (2d) 820 (1934), cert. denied 293 U.S. 558 (1934). In that case, which related to exactly the same factual situation as this one, the Sixth Circuit held that American had agreed to pay the entire consolidated tax. By the clear language of Section 240 of the 1918 Revenue Act, *supra*, the consolidated tax "shall * * * be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them * * *." The Sixth Circuit having held that American, by agreement with Louisville, had obligated itself for the whole tax, it has also necessarily held that Louisville was liable for no part of it. Yet the Court of Claims has held to the contrary.

It cannot be doubted that, if the present action had been brought in the Federal District Court at Louisville, the Sixth Circuit Court of Appeals would have adhered to its former ruling as to the existence and nature of the agreement between American and Louisville. A different result has been reached because the suit was brought in the Court of Claims instead. Decisions on questions of Federal law should not vary with the forum. This Court, in order to prevent such variations, grants certiorari to eliminate conflicts of decision and preserve uniformity in the rules of decision as applied in different parts of the Federal judiciary. The need for such review is here presented in

a particularly acute form, since there is not simply a conflict of principle, but an inconsistency between two decisions based on exactly the same facts.

Indeed, the petitioner contended below and contends here that the court below should have respected the Sixth Circuit's decision not only as a precedent, but as a determination binding on the Government under the rules of *res judicata*. The Government was a party to that case, and it is hard to see why it should not be bound by the decision even though Louisville, not being a party, was not. There is no requirement of mutuality in the application of *res judicata*. *American Law Institute, Restatement of Judgments,* Sec. 96, Comment a.

It should not be overlooked that the Government prevailed in the earlier case by proving the existence of the agreement between American and Louisville. Nothing would be more unconscionable than for the Government to collect a tax from Louisville which Louisville cannot owe if that agreement did exist. In this day of Government participation in virtually all fields of human affairs it is well to preserve the principle so well stated by Mr. Justice Holmes, that this Court will not suffer a Federal official to do a shabby thing.

3. The decision below conflicts in principle with *Noel* v. *Baskin,* 131 F. (2d) 231 (App. D. C. 1942). The Court of Appeals for the District of Columbia there held that a waiver of the statute of limitations *for an indefinite period* cannot arise by implication but must be "expressed in unequivocal terms." It also held that such a waiver, even if unequivocally made, should, "in the absence of specific language making it perpetual, * * * be held to operate only for a reasonable time." 131 F. (2d) at 232. In that case a reasonable time was held to be the same as the statutory period (computed from the date of the waiver).

In the present case, petitioner relied on Section 250 of the Revenue Act of 1918 and Section 277 of the Revenue Act of 1924, *supra,* which provide that collection proceedings must be initiated within five years after the return is filed. Louisville's separate return was filed March 15, 1919, and the five-year period for collection therefore expired March 15, 1924. Even if the limitation period were dated from American's consolidated return, which was filed February 12, 1921, the five-year period expired February 12, 1926. The suit to collect the tax here involved was not begun until August 12, 1936.

The Court of Claims rejected this contention on the ground that Louisville's surety bond, filed December 20, 1919, constituted a waiver of the statute of limitations. As will be seen from the terms of the bond, which is set forth in full in Finding 3 (R. 10-11), it contained no waiver for any specific period; indeed, it makes no reference whatever, in terms, to the statute of limitations. Under the rule of *Noel* v. *Baskin, supra,* it therefore cannot be read as a waiver for the indefinite future. The Court of Claims held, however, that it did operate as a permanent waiver—or at least that it was effective for the period of more than sixteen years which elapsed between the filing of the bond and the initiation of collection proceedings.

Moreover, even if the bond had contained an express waiver, it contained no "specific language making it perpetual." *Noel* v. *Baskin* holds that in such a case the waiver should be held to operate only for a reasonable time. The Court of Claims made no finding that sixteen years, eight months and twenty-three days was a reasonable time. Indeed, the record affords no basis for such a finding. The collection suit was not instituted until more than five years after the B. T. A. announced its decision on June 12,

1931, and over four and a half years after January 16, 1932, when its order was entered.

Surely there must be some time at which tax liabilities can be laid to rest. Under the theory of the decision below, the Government could have waited a full century or more before proceeding to collect. Granted that the sovereign can remain exempt from limitations if it so chooses, it has chosen not to do so in the field of taxation. The tax statutes announce a clear relinquishment of this ancient—and antiquated—sovereign prerogative. Unless this were so, the affairs of taxpayers could never be regarded as settled.

It may be noted that *Noel* v. *Baskin* goes farther than most of the authorities in upholding waivers of limitations statutes. In most jurisdictions permanent waiver, or waivers for an indefinite period, are held void as contrary to the public policy against litigation of stale demands. Annotation, 1 A.L.R. (2d) 1445, 1454 (1948). Some states even hold all waivers to be void, regardless of their duration. *Id.*, 1447. The ruling of the court below, in contravening even the very liberal Federal rule as expressed in the *Noel* case, not only results in a decisional conflict but presents an issue of great public importance in the administration of the income tax laws.

4. Another issue of considerable importance in the administration of the income tax laws is raised by the present case. Bluntly stated, the question is whether the officials of the Bureau of Internal Revenue, and indeed Federal officials in general, are to be held to the same legal standards of consistency and fair dealing which they are so quick to demand from private citizens.

There is no need, for present purposes, to inquire into the reasons which prompted the Commissioner to take the position that American had agreed to pay the taxes of its subsidiaries. Whether his determination to do so arose

from the fact that he thought American was more responsible financially, or (as seems likely) from the fact that he had allowed limitations to run on increasing the assessments of the subsidiaries, or from some circumstance not disclosed by the record, the unquestioned fact is that he did make a considered decision to that effect. Aided by the presumption which supports his findings, he was able to establish this position in the B.T.A. and the courts.

He then found that collection could not be made from American. We need not speculate as to whether this was because American had become insolvent, or whether (as seems likely) because the Commissioner made technical errors in the appeal to the B.T.A., or for some other reason. The plain fact is that, having discovered that the legal position he had established did not produce the dollars-and-cents result he wanted, the Commissioner then made a determination absolutely inconsistent with the agreement he had just proved to exist. It was on the basis of this determination that he rejected Louisville's claim for abatement. Such inconsistency by a taxpayer would draw the quick and justified criticism of the Commissioner.

Nevertheless the Government, because of the wording of the surety bond, was legally able to effect collection of the unpaid installment of Louisville's tax, with interest amounting to almost twice the unpaid tax itself. This was an act of power, not of right. Such collection was held by the courts to be authorized not because the tax was due, but because the tax liability could not be questioned in that proceeding.

Unless a hearing on the merits can be had in the present refund action, the Government—with full judicial approval—will have accomplished a result forbidden by the Fifth Amendment. No person can be deprived of property without due process of law, and due process includes the right to a hearing on the merits.

No one can doubt that the preservation of this principle is a matter of public importance. Its importance is particularly clear at the present time, when the Government—and particularly the Bureau of Internal Revenue—participates so deeply in our affairs. The very foundations of our society rest on the bed-rock proposition that public officials are not above the law.

Conclusion

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 581

ROYAL INDEMNITY COMPANY, A CORPORATION,
PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (R. 25–32) is reported at 92 F. Supp. 1003.

JURISDICTION

The judgment of the Court of Claims was entered October 2, 1950. (R. 32.) Petitioner's motion for new trial was denied on December 5, 1950. (R. 33.) The petition for a writ of certiorari was filed February 27, 1951. The jurisdiction of this Court is invoked under 28 U. S. C. 1255 (1).

QUESTIONS PRESENTED

1. Whether a tax assessed against a subsidiary corporation under the Revenue Act of 1918 was rendered void by the subsequent filing of a consolidated return by the parent corporation and the collection of a consolidated tax in the amount remaining after taxes previously assessed against the subsidiary had been deducted.

2. Whether the tax on the subsidiary corporation was barred by the statute of limitations.

STATUTES INVOLVED

These appear in the Appendix, *infra,* pp. 12–13.

STATEMENT

The facts found by the Court of Claims (R. 9–24) may be summarized as follows:

Louisville Woolen Mills (hereinafter called "Louisville"), all of whose stock was owned by American Textile Woolen Company (hereinafter called "American"), filed a separate income and excess profits tax return for 1918 showing a total tax liability of $129,364.93, which sum was duly assessed against Louisville. (R. 9–10.) After paying the first three installments of the tax, Louisville filed a claim for abatement of the balance of $32,341.24, on the ground that it was entitled to excess profits tax relief under the provisions of the Revenue Act of 1918. In connection with this claim, it furnished to the Collector of Internal Revenue a bond, with petitioner

herein as surety, agreeing to indemnify the Collector against any loss occasioned by the delay incident to consideration of the claim. (R. 10–11.) Thereafter the Commissioner of Internal Revenue advised American that its income and excess profits tax for 1918, together with that of Louisville and other affiliated corporations, should be determined and computed upon a consolidated basis under Section 240 of the Revenue Act of 1918. (R. 11–12.)

In 1921, American filed a consolidated return for 1918, showing a total consolidated tax liability of $351,034.14, but this amount was never formally assessed. American later paid $100,000 on account of the tax shown on this return, which amount was assessed against it and applied as a credit against the tax shown by the consolidated return. (R. 12.)

After final audit of the consolidated return, the Commissioner determined a total consolidated tax liability of $429,539.94, and a deficiency of $33,-929.20. This deficiency was determined by deducting from the consolidated tax liability the taxes previously assessed against the several affiliated corporations, including the total tax theretofore assessed against Louisville. (R. 16–17.) American appealed to the Board of Tax Appeals (now the Tax Court), which sustained the Commissioner's action in determining a consolidated tax deficiency against American. 23 B. T. A. 670. Upon settlement of this deficiency

pursuant to Rule 50 of the Board, credit was again given to American for the total amount of taxes which had previously been assessed against the several corporations (including Louisville) of the consolidated group. (R. 18–22.) American appealed from the deficiency determination to the Sixth Circuit Court of Appeals, which, on February 16, 1934, affirmed the Board's decision. 68 F. 2d 820. Certiorari was denied. 293 U. S. 558. The deficiency in consolidated tax determined against American was duly assessed against that company on August 27, 1932. The deficiency was compromised by agreement of May 10, 1938, between American and the Attorney General; and the compromise agreement contained a stipulation that it did not cover the subject matter of the bond given by petitioner as surety in connection with the tax assessed against Louisville. (R. 22–23.)

Louisville's claim for abatement of the tax assessed against it (and deducted in computing the consolidated tax deficiency) was formally rejected by the Commissioner after notice of rejection was sent Louisville by letter of August 23, 1932. After rejection of the claim, the Collector demanded from Louisville, and from the petitioner as surety, the unpaid portion of the tax. Payment was refused, and the United States instituted suit for collection against Louisville and petitioner, on August 12, 1936, in the United States District Court. Louisville was insolvent

at the time, and made no defense to the action. The District Court entered judgment in favor of the United States against petitioner, and its judgment was affirmed by the Sixth Circuit Court of Appeals. 120 F. 2d 136. Certiorari was denied on January 12, 1942. 315 U. S. 797. Petitioner paid the judgment on January 28, 1942. (R. 23–24.)

Petitioner then filed claim for refund of its payment. The claim was denied, and this suit for refund followed. (R. 24.) The Court of Claims unanimously held that petitioner was not entitled to the refund. (R. 25–32.)

ARGUMENT

This case presents neither an important question nor a conflict. It involves provisions of the 1918 Revenue Act which have long since been changed, turns on its unique facts, and was correctly decided by the court below.

1. Section 240 (a) of the Revenue Act of 1918, Appendix *infra,* p. 12, provides that if a tax is "assessed upon the basis of a consolidated return," the consolidated tax shall be assessed upon the respective affiliated corporations in the proportions agreed upon among them. The Court below held that a tax which had been assessed against a subsidiary corporation (Louisville) on the basis of a separate return of that corporation was not wiped out by the subsequent filing of a consolidated return by the parent (American), since the consolidated tax assessed against the

parent was determined by deducting the tax previously assessed against, and assumed by, the subsidiary. Having concluded that the subsidiary was not relieved of payment of the tax assessed against it and credited against the consolidated tax liability, the court below concomitantly held that petitioner, the surety on the bond given to secure payment of the tax, was not relieved. Its holding is clearly warranted by the undisputed facts.

2. Ignoring both these facts and the reasoning of the court below, petitioner contends (Pet. 7–10) that it has been denied a hearing on the "legality" of the tax assessed against Louisville. There is not the slightest justification for its complaint, or for the tone of indignation in which it is couched. As is plain from its opinion, the court below fully considered the legality of the assessment against Louisville in holding that petitioner as surety was obliged to pay the tax. After analyzing the facts showing that the tax assessed against Louisville had been credited against the consolidated tax liability, the court below observed (R. 31) that Louisville itself had no defense to payment, and that "The rights of plaintiff, as surety on the bond given to secure the payment of the tax, can be no greater than those of Louisville."

Far from having been deprived of a hearing on the legality of the tax in question, petitioner has been afforded two full hearings: first, in the

Government's action to collect the tax (*Royal Indemnity Co.* v. *United States,* 120 F. 2d 136 (C. A. 6), certiorari denied, 315 U. S. 797), and again in this suit to recover back the amount paid in satisfaction of the judgment obtained against it in that action. Indeed, petitioner is seeking by this refund suit to accomplish indirectly what it could not achieve directly in the Government's collection suit, for substantially the same arguments it here advances in support of its claim for refund were rejected on their merits as defenses to the Government's collection suit.[1] To grant the refund would nullify the judgment obtained in that suit.

3. The decision below is not in conflict with *American Textile Woolen Co.* v. *Commissioner,* 68 Fed. 2d 820 (C. A. 6), certiorari denied, 293 U. S. 558, as petitioner asserts (Pet. 10–11), but on the contrary is in harmony with it. That case involved the question of whether the deficiency in consolidated tax which was ultimately assessed against American was payable by American or the subsidiaries, and it was held payable by American on the basis of an agreement among the affiliated companies. The tax here involved, however, was never reflected in the deficiency in consolidated tax which was determined and assessed against American. It had already been assessed against Louisville, and it was deducted in com-

[1] See the opinion of the Sixth Circuit Court of Appeals in *Royal Indemnity Co.* v. *United States, supra* at pp. 138–139.

puting the consolidated tax liability assessed against American. As the court below observed (R. 31), "the Commissioner listed and credited against the total tax of the consolidated group the amounts of taxes already assessed against the several corporations," and, in its redetermination of the deficiency, the Tax Court "did likewise." By its own terms, Section 240 (a) of the 1918 Act applies only in a "case in which a tax is assessed upon the basis of a consolidated return," and the only amount which was here "assessed" on the basis of the consolidated return was the "deficiency" in consolidated tax arrived at by deducting the amounts theretofore assessed against Louisville and other members of the consolidated group. Moreover, as the court below pointed out (R. 31–32), the statute in effect at the time the deficiency in consolidated tax was determined (Section 273 of the Revenue Act of 1924, *infra,* p. 13) defined a "deficiency" as the difference between the amounts of tax previously "assessed" (or collected without assessment) and the tax determined to be due. The consolidated tax "deficiency" involved in the *American Textile* case was (R. 32) the amount determined "after allocating to the several corporations the taxes which had been assessed against them." Significantly, the same court which decided the *American Textile* case also later decided the *Royal Indemnity Co.* case, with which the decision below is in complete accord.

4. Nor is there any conflict with *Noel* v. *Baskin*, 131 F. 2d 231 (C. A. D. C.), as petitioner alleges (Pet. 11–13). The case bears no resemblance to this one, either on its facts or as to the issue presented. In the first place, the asserted conflict seems to rest in part, at least, upon petitioner's gratuitous assumption that the assessment against Louisville (admittedly timely made) was erased by the determination of a deficiency in consolidated tax, and its corollary assumption that any new assessment against Louisville is now barred by the statute of limitations. As the court below concluded (R. 32), the fact that a deficiency in consolidated tax was determined (after crediting the tax previously assessed against Louisville), and that American agreed to assume any liability for this deficiency, "did not * * * render void the assessments previously made or cause the collection of tax and interest, here involved, from the Louisville Woolen Mills or the plaintiff, to become barred under any statute of limitation."

In the second place, there is no question in this case as to whether the filing of a surety bond can constitute a waiver of the statute of limitations "for the indefinite future." Cf. Pet. 12. For the claim for abatement filed by petitioner's principal, Louisville, is shown to have been rejected by the Commissioner shortly after the Board of Tax Appeals had passed on the question of the consolidated tax deficiency, and sometime after August 23, 1932 (R. 23, Fdgs. 27 and 28).

It was only four years later, on August 12, 1936 (R. 24), that the Government brought suit on the bond. As this Court ruled in *United States* v. *John Barth Co.*, 279 U. S. 370, 375–376:

> * * * The making of the bond gives the United States a cause of action separate and distinct from an action to collect taxes which it already had. * * * If there is any limitation applicable to a suit on the bond, * * * it has not yet become effective.
>
> * * * * *
>
> * * * To avoid the result usually ensuing from the return which he himself made, the taxpayer was permitted by a bond temporarily to postpone the collection and to substitute for his tax liability his contract under the bond. The object of the bond was not only to prevent the immediate collection of the tax but also to prevent the running of time against the Government. The taxpayer has obtained his object by the use of the bond, and he should not object to making good the contract by which he obtained the delay he sought.

5. There is no substance in petitioner's suggestion (Pet. 13–15) that the Commissioner has been inconsistent in demanding payment of both the tax assessed against Louisville and that assessed against American. The amount assessed against American was computed by deducting the amount assessed against Louisville. Peti-

tioner's contentions, if sustained, would produce the anomalous result that the tax in question is not collectible from anyone—neither from Louisville, against whom it was assessed and who became insolvent; nor from petitioner, who guaranteed its payment; nor from American, whose consolidated tax liability was determined by crediting the tax assessed against Louisville.

CONCLUSION

The decision below is correct, and there is no occasion for further review. The petition for a writ of certiorari should be denied.

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MAY, 1951.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057:

> Sec. 240. (a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital for the purposes of this title and Title III, and the taxes thereunder shall be computed and determined upon the basis of such return: * * *
>
> In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. * * *
>
> (b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls * * * substantially all the stock of the other or others, * * *.
>
> * * * * *
>
> Sec. 250.
>
> * * * * *
>
> (d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the

Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. * * *

* * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253:

Sec. 273. As used in this title the term "deficiency" means—

(1) The amount by which the tax imposed by this title exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; * * *

* * * * *

Sec. 274. (a) If, in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the taxpayer, except as provided in subdivision (d), shall be notified of such deficiency by registered mail, but such deficiency shall be assessed only as hereinafter provided. Within 60 days after such notice is mailed the taxpayer may file an appeal with the Board of Tax Appeals establishment by section 900.

(b) If the Board determines that there is a deficiency, the amount so determined shall be assessed and shall be paid upon notice and demand from the collector. * * *

* * * * *

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MAY 25 1951
CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

October Term, 1950.

No. 581.

ROYAL INDEMNITY COMPANY,
a Corporation, - - - - - - Petitioner,

versus

UNITED STATES OF AMERICA, - - - Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

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ROYAL INDEMNITY COMPANY,
A CORPORATION, - - - - - - *Petitioner,*

v.

UNITED STATES OF AMERICA, - - *Respondent.*

REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

May it please the Court:

The respondent's brief in opposition to the petition for certiorari beclouds the issues in several important respects. We therefore submit this reply brief, for the sole purpose of assisting the Court to understand the true issues in the case.

I. RESPONDENT'S STATEMENT OF THE QUESTIONS PRESENTED IS NEITHER ACCURATE NOR COMPLETE.

The respondent's statement of the questions presented is not accurate. The question is not whether the asessment against Louisville was rendered void by the "filing of a consolidated return * * * and the collection" of a tax from American. The question is whether Louisville's tax liability was adjudicated to be non-existent by a *judgment* holding that the entire consolidated tax was assessable against American and only against American. The issue is correctly set forth as Question 4 at pages 2-3 of the petition.

Furthermore, the respondent's statement of the questions presented is not complete. Questions 1, 2, 5 and 6, set forth in the petition, are properly raised on this record and are before the Court.

II. RESPONDENT'S STATEMENT OF FACTS IS MATERIALLY ERRONEOUS.

The respondent's statement of the facts contains one error which pervades its entire argument. The error is found in respondent's assertion that the Board of Tax Appeals, in determining American's deficiency, credited American with the amount of the uncollected assessment against Louisville which is here in question. On the basis of said assertion (which is erroneous, as we shall hereafter show), the respondent contends in effect that the tax on Louisville is justified by a tax

benefit to American, Louisville's parent corporation, resulting from the assessment against Louisville.

Let us see what the record shows as to how the B. T. A. determined the amount of the deficiency.

The record shows that the B. T. A. found, as a matter of substantive law, that American was liable for the entire consolidated tax, without abatement for taxes assessed against, or even for taxes paid by, the subsidiaries. Its opinion, which is incorporated in the record by citation in Finding 17 of the court below (R. 18), recognizes and regrets the fact that this would result in double liability for the affiliated group as a whole. At 23 B. T. A. 697-698, the Board said:

> "Our decision is not based upon the theory of estoppel advanced by the respondent, and *to the extent that it may result in the payment of consolidated taxes upon income on which taxes have already been paid by the companies severally, is reluctantly rendered.* We are, however, of opinion that there existed among the petitioner and its subsidiaries an agreement that consolidated tax liabilities of the affiliated group for the years 1917, 1918, and 1919 should be allocated for assessment to petitioner alone. See *Bermont Oil Co.*, 22 B. T. A. 182, and cases cited therein." (Emphasis added.)

And in his proposed settlement under Rule 50, the Commissioner sought to take full advantage of this ruling by claiming a deficiency balance of $299,519.56. (Finding 18, R. 18.)

It then was discovered, however, that the Commissioner had made a procedural error. Not anticipating the huge and unjust windfall which would accrue to the Government if the B. T. A. sustained his position, he had made no motion to enlarge the deficiency of $33,929.20 proposed in his deficiency letter. Under the law as previously announced by the Board in *Pitman* v. *Commissioner,* 24 B. T. A. 244 (decided September 30, 1931), the Commissioner was thereby disabled to obtain judgment for more than $33,929.20, even though on the merits he had established his claim for $299,519.56. Counsel for American pointed this out in the hearing before Member Love on settlement under Rule 50. Member Love, who had just written the Board's opinion in the *Pitman* case, expressed agreement with this position. (Finding 21, R. 20-21.)

The record does not expressly show on what basis the B. T. A. arrived at its judgment as to the amount of American's deficiency. No opinion was written explaining the computation of the judgment, and after a lapse of nearly two decades it has been impossible for either party to adduce any direct evidence on that point in this case, except of course the Board's opinion on the merits reported in 23 B. T. A. 670. However, such inferences as can legitimately be drawn from the record point unmistakably to the conclusion that the Board's judgment was based on the Commissioner's failure to enlarge the proposed deficiency set forth in the 60-day letter, and was *not* predicated on the allowance of a credit to American for taxes assessed against its subsidiaries.

In the first place, the allowance of such a credit would have directly contravened the Board's official opinion on the merits. This opinion was never withdrawn or modified, and thus establishes, at least *prima facie,* the Board's reasoning.

In the second place, there is no indication that the Board disagreed with Member Love's view, referred to above, that the Commissioner was limited to the deficiency proposed in his 60-day letter.

In the third place, we are not left in doubt as to the Board's reason for entry of judgment in the amount of $39,362.70 instead of the $33,929.20 deficiency proposed in the 60-day letter. The difference of $5,433.50 is explained in Finding 20. (R. 19-20.) It resulted from American's voluntary action in consenting to this increase.

The record does not inform us, and we do not know, what motivated this seeming concession. It resulted from a change in the Commissioner's figure for taxes assessed against and paid by Sweetwater Woolen Mills, another subsidiary of American which is not a party to this record. Perhaps the concession was made in return for a reciprocal concession by the Commissioner with respect to Sweetwater. Perhaps it was made in recognition of a simple clerical error contained in the 60-day letter, which American for reasons of its own did not wish to take advantage of. Since Louisville and petitioner, its surety, were not represented in that proceeding, we have no way of knowing why the concession was made. But for that very reason it would be doubly improper to make the inference, for the pur-

pose of imposing a tax liability on Louisville and petitioner, that the *Board,* repudiating *sub silentio* its then recent ruling in the *Pitman* case, had held that the Commissioner was not, as a matter of law, limited to the amount claimed in the 60-day letter. The most that can be inferred is that American, for reasons of its own, *consented to a strictly limited relaxation of the* Pitman *rule.*

We regret the necessity of analyzing the record at such length. We cannot, however, leave unchallenged the implication contained in respondent's brief, that the assessment against Louisville produced a tax benefit for its parent corporation in the B. T. A. It simply is not so.

III. RESPONDENT'S LEGAL POINTS ARE NOT WELL TAKEN.

(a) It is not true, as respondent asserts, that this case involves no question of importance because it "involves provisions of the 1918 Revenue Act which have long since been changed." The case involves an important question of limitations under extension bonds, which are still used in administration of the income tax laws. Reg. 111, Sec. 29.56-2.

The case also involves basic questions of administrative fairness, which have a continuing and increasing importance. Two decisions of the Court of Appeals for the District of Columbia, handed down after the filing of the petition for certiorari in this case, afford ample confirmation of the present importance

of such cases. In *Stockstrom* v. *Commissioner*, 51-1 USTC Par. 10, 801 (decided March 29, 1951), the Commissioner of Internal Revenue had sought to take advantage of the taxpayer's failure to file a gift tax return, despite the fact that said failure resulted from the taxpayer's reliance on a ruling of the Commissioner which was subsequently changed. The Court held in favor of the taxpayer, saying:

> "It has been well said that the government should always be a gentleman. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials. We regard as unconscionable the Commissioner's claim of authority to assess a tax in 1948 because of Stockstrom's failure to file a return for 1938, when the Commissioner himself was responsible for that failure."

And on May 18, 1951, in the case of *Dollar* v. *Land*, the same court held a number of high Federal officials, including the Secretary of Commerce, to be in contempt because of their refusal to comply with the mandate of the court. According to the *New York Times*, May 19, 1951, page 25, the Court rejected the contention of the officials that as agents of the sovereign Government they enjoy a privileged status, saying:

> "There is nothing new in the difficulties of that position. It has existed at least since the English judges began to assert the supremacy of the common law over government absolutism."

Preservation of the principle that executive officials of the United States Government are not above the law is a matter of unequaled importance; and more than a few such officials today are challenging, by their

acts if not by their words, the present validity of that principle.

(b) Point 1 of respondent's argument fails to meet the issue. As stated above, the question is not whether Louisville's assessment was nullified by the *filing of the consolidated return,* but whether it was wiped out by a *final judgment* that American alone was liable for the consolidated tax.

(c) Point 2 of respondent's argument is based on an erroneous premise. Respondent says that the court below "fully considered the legality of the assessment against Louisville." The lower court's opinion shows on its face that it did not do so. The court said that the Sixth Circuit Court of Appeals in *American Textile Woolen Co.* v. *Commissioner,* 68 F. 2d 820 (1934), cert. denied 293 U. S. 558 (1934), had "finally determined" Louisville's tax to be due, and that its decision "cannot be questioned here." (R. 30.) For that reason, the court below refused to pass on the substantive question of Louisville's liability for the tax.

Nor is it true, as respondent asserts, that petitioner was afforded a hearing on the merits in *Royal Indemnity Co.* v. *United States,* 120 F. 2d 136 (1941), cert. denied 315 U. S. 797 (1942). The court there made certain statements bearing on the substantive question of Louisville's tax liability, which statements are made the subject of a footnote reference in respondent's brief. The court made it plain, however, that these statements were pure dictum. It expressly held (p. 139):

> "The liability for the tax as tax may have been terminated, *though this we do not decide,* or, as in United States v. John Barth Co., 279 U. S. 370, 49 S. Ct. 366, 367, 73 L. Ed. 743, collection may become impossible because of the running of time, but this has no bearing upon the obligation of the surety upon the bond." (Emphasis added.)

It is clear, both on principle and on authority, that the due process requirement of an opportunity for hearing is satisfied only by an opportunity for a full hearing *on the merits. Central of Georgia R. Co.* v. *Wright,* 207 U. S. 127 (1907); *Turner* v. *Wade,* 254 U. S. 64 (1920); *Brinkerhoff-Faris Trust & Savings Co.* v. *Hill,* 281 U. S. 673 (1930).

(d) Point 3 of respondent's argument explains how the *Commissioner* happened to propose a deficiency of only $33,929.20 in his 60-day letter. It has nothing to do with the decision of the B. T. A. and the Sixth Circuit Court of Appeals in the *American Textile Woolen Co.* case, and fails to reconcile that decision with the decision of the Court of Claims in this case.

It is true that the *Commissioner's* determination of deficiency, embodied in his 60-day letter, was computed on the basis of credits for all taxes previously assessed, including the assessment against Louisville which is involved in this case. That determination, however—as the court below expressly found (Findings 11 and 13, R. 16, 17)—was made not for American alone but for "American *and its subsidiaries.*" It was obviously necessary for the Commissioner, in determining the deficiency for the entire affiliated group, to take ac-

count of assessments against the subsidiaries as well as American.

But at that stage of the proceedings, in 1925, the Commissioner had not yet developed the ingenious theory that American (by virtue of an implied agreement) was alone liable for the entire consolidated tax. That idea appeared only after the Commissioner, by failing to address his 60-day letter properly, had lost the right to make additional assessments against the subsidiaries.

The sequence of events is instructive. First the Commissioner sought to propose a deficiency against the entire affiliated group, in the amount of $33,929.20. Because of an error in the address of the 60-day letter, he was limited to an assessment against American. He then "found" that American had assumed the obligation to pay the whole consolidated tax, and American was unable to convince the B. T. A. that it had not done so. The logic of the B. T. A.'s decision would have given the Commissioner a windfall of more than $200,000.00, except for his failure to make a motion to enlarge the proposed deficiency. Consequently, the Commissioner obtained judgment only for the proposed deficiency, plus $5,433.50 voluntarily conceded by American.

From the above recital it becomes crystal clear that the B. T. A. allowed American no credit for taxes assessed against Louisville. The Commissioner had allowed such a credit to the affiliated group as a whole, but his subsequent shift of position rendered immaterial the assessment against the subsidiaries; and, in any

event, the Commissioner's *ratio decidendi* has no bearing on this case.

(e) Point 4 of respondent's argument misconceives the nature of the limitations question here involved. We do not claim that the *assessment* against Louisville came too late. We claim, rather, that the *collection* came too late. The applicable limitations statutes, set forth in the petition, contain time limits for collection as well as assessment.

(f) Point 5 of respondent's argument is unsupported by the record and is contrary to fact. It is not true that our position would "produce the anomalous result that the tax in question is not collectible from anyone." Our position is that only one taxpayer, not two, can be primarily *liable* for the tax in question. We submit, further, that there is nothing "anomalous" about the inability of the Government to *collect* a valid tax; such a result often ensues where a taxpayer becomes insolvent (as American did here) or where the Commissioner permits the statute of limitations to run (as we think he did here).

The *collectibility* of the tax depends on (a) the financial responsibility of the person who is obligated for it, and (b) the adherence by the tax authorities to the procedural rules established by law. We submit that tax liability does not depend on the financial responsibility of the taxpayer, and that Louisville's liability is neither enlarged nor diminished by the fact that petitioner, its surety, is at present the only solvent person in sight. We submit further that petitioner, by executing Louisville's bond, did not absolve the

Commissioner from his duty to follow established legal procedures, or assume the risk of the remarkable results which have flowed from the Commissioner's efforts to escape the consequences of his own procedural irregularities.

Finally, we submit that no one can say, at the present time, whether the Government is better or worse off financially as a result of the filing of the abatement claim and bond, and the consequent delay in collection of the tax here in question. For all that appears, if Louisville had been forced in 1921 to pay the tax here in question, it might have filed a timely claim for refund of its entire 1918 tax rather than only one-fourth of it; and, in the light of subsequent events (including the adjudication of American's liability for the whole consolidated tax, and American's subsequent insolvency) this might have worked to the Government's ultimate disadvantage.

It is fruitless, however, to speculate on such possibilities. Where insolvency has intervened, it is never possible to reconstruct hypothetical tax consequences. The only possible approach is to accept and be guided by the rules of law laid down by Congress and the courts. And on this basis it is clear that, for the reasons set forth in the petition, this Court should grant certiorari and reverse.

Respectfully submitted,

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